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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation in South Vietnam

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June 1972

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Summary

1. The economic impact of the offensive has varied considerably from region to region -- rural areas directly involved in the fighting have suffered severe losses in output, while in other regions economic activity goes on much as usual. In Saigon and other urban areas in recent weeks there has been some restoration of consumer and business confidence. Retail prices have remained relatively stable in all areas. However, the modern sector of the economy -- primarily durable goods manufacturing and the import trade centered in Saigon -- still is in a serious recession.

2. A new investment law has eliminated some of the obstacles to investment in South Vietnam, but the war is still the major deterrent. Although foreign investors showed considerable interest last year when security was relatively good, they actually put very little money into South Vietnam.

3. The availability of government and private bank credit in rural areas increased markedly in 1971 as the result of the September 1970 interest rate reform and the expansion of the private rural banking system. The Agricultural Development Bank and the private rural banks provided an estimated 13% of rural credit requirements in 1971 compared with only 6% in 1967.

4. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget (Figures 1-5) follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

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CONFIDENTIAL**Discussion**Current Developments

5. As the offensive wears on, the extent of its impact on the economy has become somewhat clearer. Recent press reports notwithstanding, the economy is not in desperate straits nor are there signs that the unemployed are about to riot in the streets of Saigon. However, certain sectors of Saigon's economy are in the midst of a serious recession, and some rural areas where the fighting has been heavy have suffered production losses. The refugee problem, although manageable, is still enormous. On the other hand, there are many parts of the country – including those most densely populated – where life goes on pretty much as usual. Military activity has picked up in some Delta provinces, but economic activity there and in other parts of the country has not yet slowed appreciably.

Urban Areas

6. The modern sector of Vietnam's economy, which is centered in Saigon, remains in a depressed state, although there has been some restoration of consumer and business confidence with the improvement in the military situation. This sector includes primarily durable goods manufacturing, the import trade, and entertainment establishments. Consumers began retrenching on luxury spending at the start of the offensive and are still deferring purchases of these and some other goods. As a result, manufacturers and importers have been left with large inventories financed at high interest rates and accordingly have been forced to cut back output and orders for imports. To date, these cutbacks have resulted in shorter hours and reduced pay but few layoffs. Employees of such establishments as restaurants, bars, and nightclubs also have suffered pay cuts, but their plight is tied more to the reduced number of US troops, the early curfew, and government closures.

7. Commodity prices in Saigon have remained quite stable throughout the offensive. By 12 June the USAID retail price index was up only 3% over the pre-offensive level (9% for the year). Most of the increase since March occurred in late May, reflecting seasonal declines in supply of some foodstuffs and the tax increases levied by the government on 22 May to help meet the cost of the offensive. Rice prices declined somewhat during the past month as deliveries from the Delta increased.

8. Commodity markets in other urban areas reportedly have been stable since the end of April despite the ebb and flow of refugees. The danger of a rice shortage in the northern provinces seems to have passed.

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With government persuasion, farmers have been shipping larger quantities from the Delta to Saigon, and no major upsurge in the fighting has disrupted transportation between Saigon and the north. Of the more than 800,000 people who are refugees, the government is now caring - with relative efficiency - for about 675,000 in camps located primarily in urban areas. Da Nang still houses more than 350,000 refugees, or almost twice its normal population. Hue's population, most of whom left following the fall of Quang Tri at the end of April, has returned to more than half its normal size. US observers estimate that about three-fourths of the shops in Hue's commercial area are open, although sales are below normal.

9. Black market dollar prices in Saigon have fallen almost steadily since the offensive began, and during early June they dropped four piasters below the legal rate of 420 piasters per dollar. This apparently reflects the heavy demand for piasters by businessmen caught in a credit-inventory squeeze. Demand for gold has fallen for the same reason, as indicated by the general downward trend in gold leaf prices since the offensive began (see Figure 4). The price of gold, however, rose slightly during the week ending 12 June, reportedly because of an increase in gold prices in Hong Kong.

Rural Areas

10. In rural areas the economic impact of the offensive has generally been confined to the combat zone, with only moderate disruption elsewhere. Rice shipments from the Delta, for example, were disrupted temporarily in early May by fighting in Bac Lieu and Ba Xuyen Provinces but have since been moving normally. At present, agricultural experts in the Delta expect rice production there to equal or exceed last year's crop despite scattered security problems. If enemy activity increases in the Delta, however, this estimate will have to be changed accordingly.

11. In areas directly involved in the offensive, economic activity has virtually come to a halt. Most of the large rubber plantations in Military Region (MR) 3 were shut down by mid-April. Vietnam's only cement plant - in Kien Giang Province in MR 4 - was occupied by North Vietnamese troops for several days at the end of May. As a result of the damage suffered, the plant will be shut down for about 90 days. The US Embassy reports, however, that stocks of cement are plentiful and no shortages should occur before the plant resumes production. Timber production has also suffered because the government has halted forestry operations in several provinces for three months. This was done to prevent food and other supplies from reaching large enemy troop concentrations. Trucks carrying logs out of enemy-held forest areas apparently have been transporting food for the enemy as the price of re-entry.

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12. These three products – rubber, cement, and timber – provide employment for relatively few people, but rubber and timber are important to South Vietnam's small export trade. During the first four months of 1972, rubber and timber accounted for 49% of total exports of \$7.4 million. Other items such as shrimp and scrap metal may take up some of the slack, but exports clearly will not be as large as anticipated at the start of the year.

Investment Law Passed

13. Although the war continues to be the major deterrent to foreign investment in South Vietnam, the government has taken steps to eliminate some of the other obstacles. On 5 June, President Thieu signed a new investment law with features as attractive – if not more so – than similar laws in neighboring countries.

14. The investment law, which replaces one passed in 1963, has several attractive new features, including a pledge by the government not to compete against or nationalize any approved projects. It also provides that enterprises may be wholly foreign-owned and that net profits may be fully repatriated each year. Exemptions from import duties on machinery and equipment and five-year exemptions from various taxes are among the provisions similar to those in the 1963 law. In addition to the law itself, an investment service center was recently set up in the Ministry of Economy with the intention of providing one-stop service to foreign and domestic investors. Finally, in March a National Economic Development Fund of 10 billion piasters (\$24 million, if converted at 420 piasters per dollar) was established from US aid funds to provide medium-term loans for private sector investment projects.

15. The success of these attempts to improve the investment climate, however, will hinge largely on how the provisions of the new law and the activities of the investment center are administered. If the center works out as planned, it could be a major aid to investors, who heretofore have often spent as long as two years finding their way through a maze of government offices and documents. The new law still allows scope for considerable discretion in project approvals. A committee composed of government and private sector representatives appointed by the Prime Minister will administer its provisions. It remains to be seen whether this group can withstand the sorts of corruption common to Vietnam and thus be able to administer investment policy fairly and efficiently.

16. Because of the offensive, many of the new investment procedures probably will not be used for some time. Despite the number of inquiries and tentative plans for investing in Vietnam last year when security conditions were relatively stable, foreign investors remained cautious.

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According to the US Embassy, only four small projects with foreign participation were actually started in 1971. The total foreign investment in them was just under \$1 million. There was more activity among local investors, who were granted privileges under the 1963 investment law for 35 projects. Total investment in these amounted to 9.7 billion piasters (\$23 million), of which the four projects involving foreign capital accounted for only about 10%. Eight more locally sponsored projects capitalized at 1.1 billion piasters (\$2.6 million) were approved during the first quarter of 1972. These projects, however, probably will not come to fruition, nor will new ones be proposed until the fighting dies down.

Expansion of Rural Credit

17. The government and private banks have made substantial gains in meeting rural credit needs over the past few years. According to a US Embassy estimate, the government's Agricultural Development Bank (ADB) and the ADB-sponsored private rural banking system provided 13% of rural credit in 1971, compared with only 6% in 1967. The bulk of credit still comes from friends, relatives, moneylenders, and small informal lending groups called *huis*.

18. Institutional savings and credit activity both expanded rapidly in 1971 as the result of the September 1970 interest rate reform and the expansion of the private rural banking system. During 1971 the number of these banks grew from four to 21 and four more have been opened this year. All but seven of the private banks are located in MRs 3 and 4. As late as April, plans were still under way in the Delta for the opening of several more.

19. Total loans made by both the ADB and the private banks increased 59% to 11 billion piasters (\$26 million) in 1971. The number of borrowers rose from 120,000 to 180,000. That the number is still so small, however, indicates how far the rural credit program has yet to go. The ADB, with offices in the provincial capitals, still handles more than 90% of the loan activity, but plans call for the private banks to provide almost 20% of the institutional credit flow in rural areas by 1975.

20. Deposits also rose rapidly from 400 million piasters to 1.5 billion piasters, of which the ADB held about 85%. In addition to deposits and its initial capital of 2.5 billion piasters, the ADB supplements its resources primarily by borrowing from the National Bank of Vietnam. The private banks in turn draw on the resources of the ADB.

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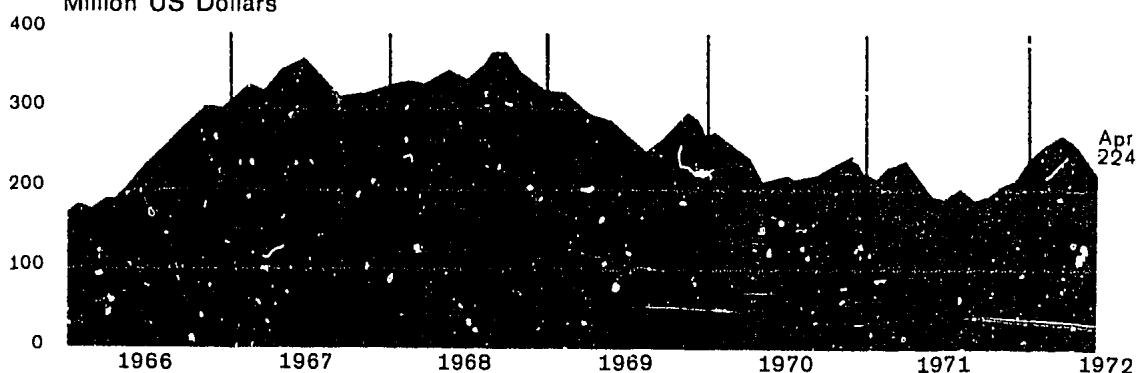
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Figure 1

Foreign Exchange Reserves*

Million US Dollars



*Excluding holdings of commercial banks

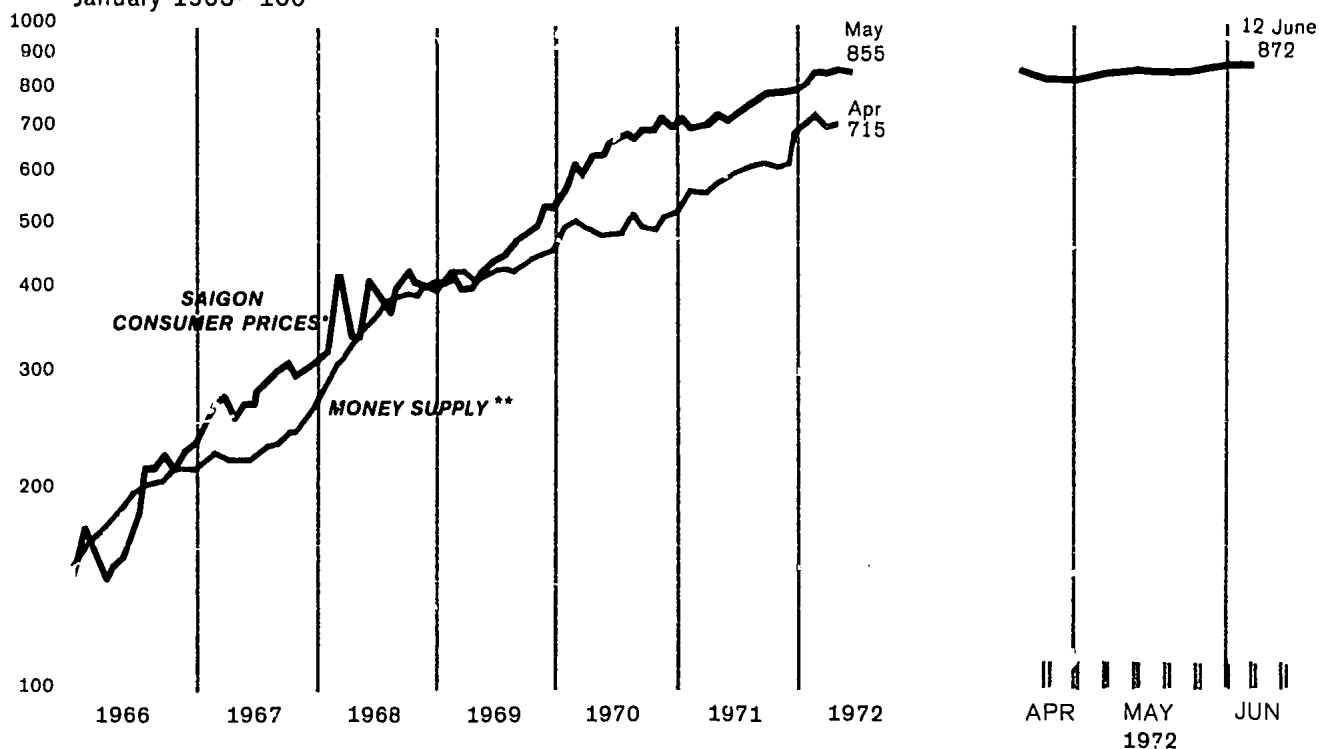
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Figure 2

Indexes of Money Supply and Saigon Consumer Prices

January 1965=100



*USAID monthly average retail price index for Saigon

**Data are for end of month

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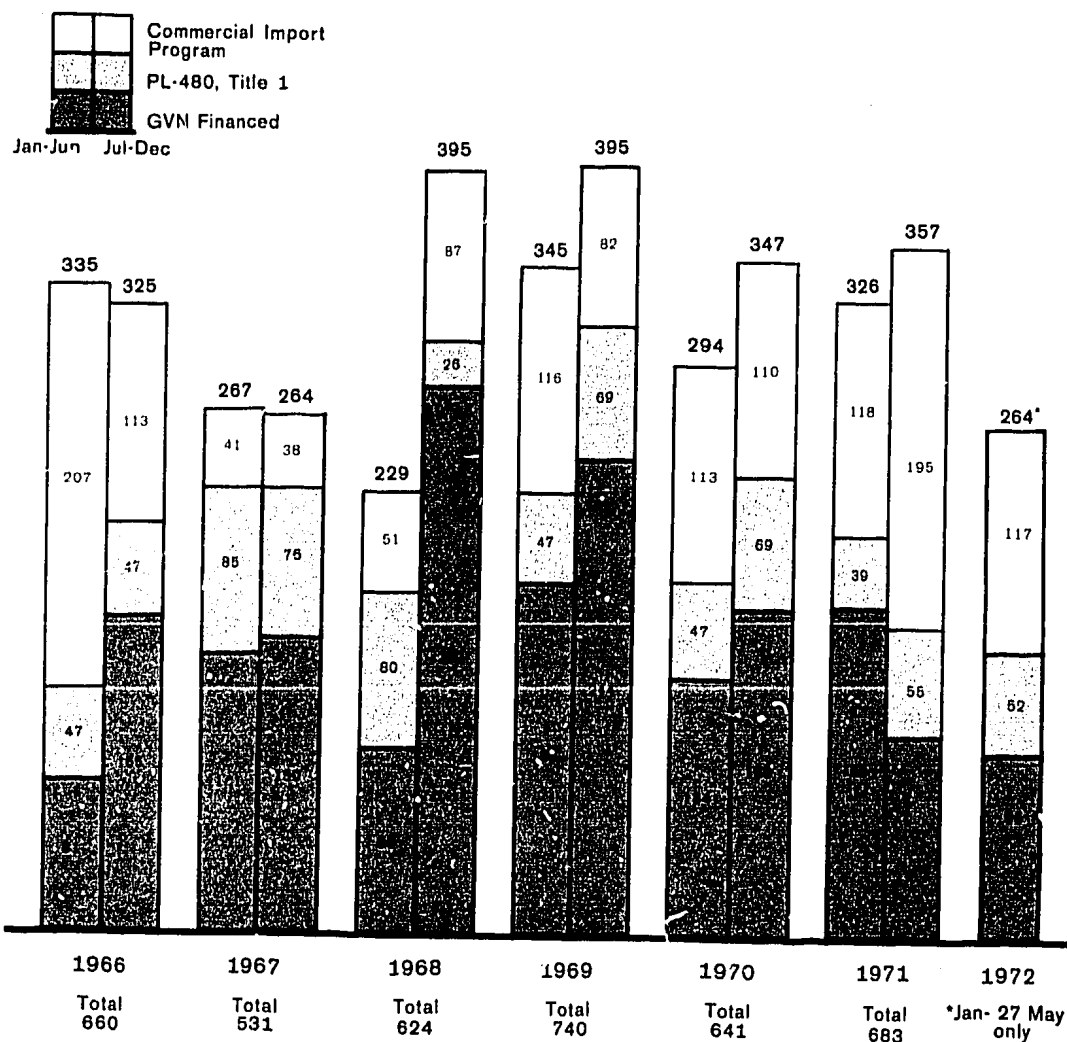
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Import Licensing

Million US Dollars

Figure 3



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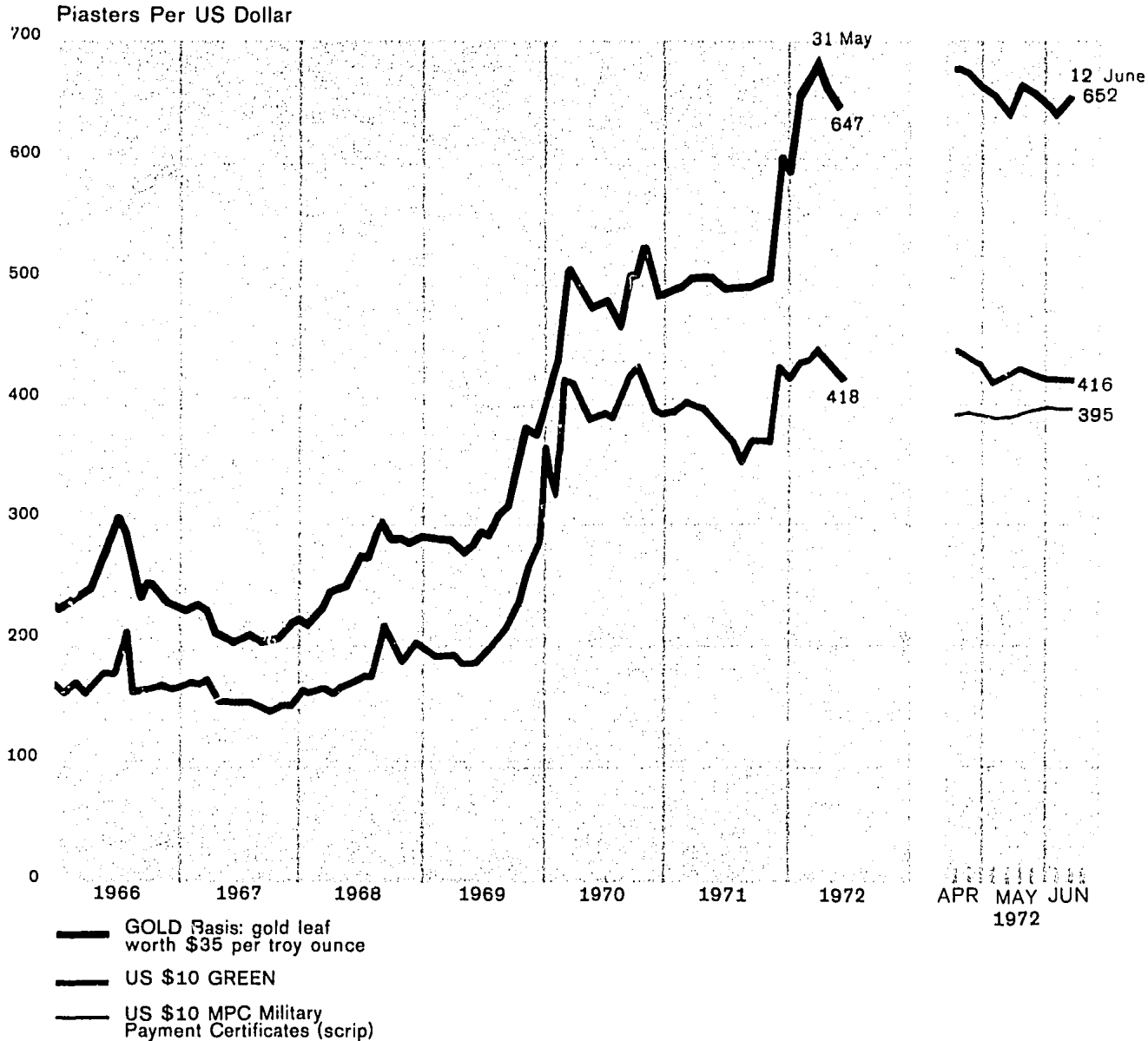
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Figure 4

Free Market Gold and Currency Prices



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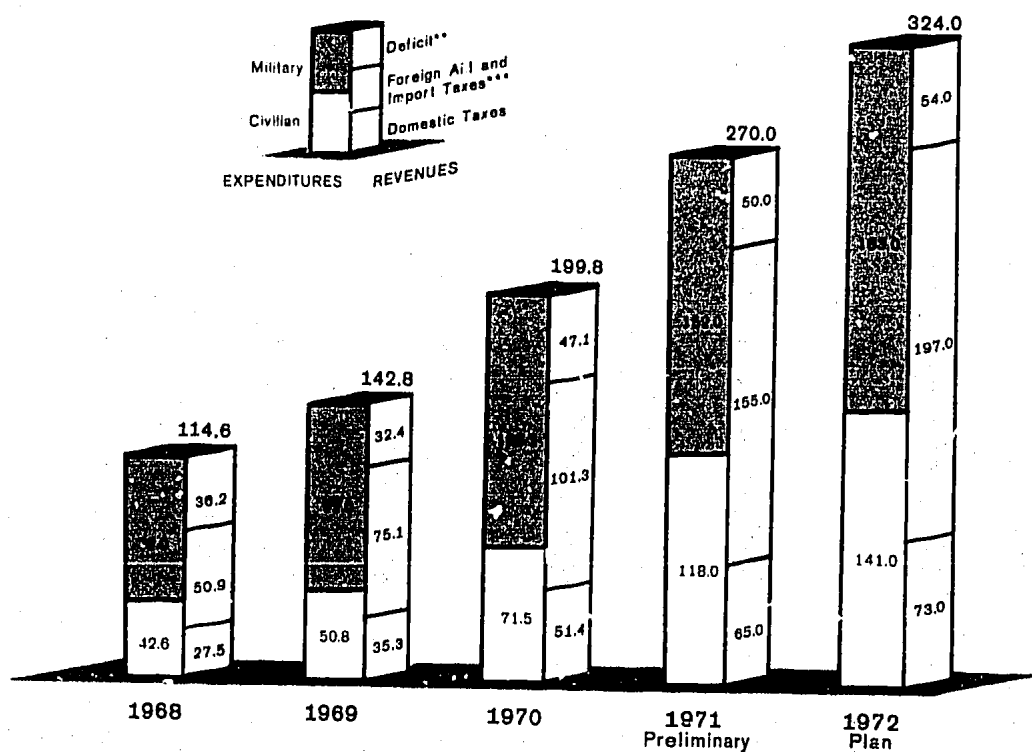
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Government Budget*

Billion Piasters

Figure 5



*Data include extrabudgetary revenues and expenditures.

**Residual. Financed primarily by borrowing from the National Bank.

***Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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